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USDOC/ITA/IA/JTERPSTRA

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SUBJECT: PROBLEMS LOOMING FOR SOFTWOOD LUMBER DEAL

Classified By: AMBASSADOR DAVID WILKINS FOR REASONS 1.4 (B) AND (D)

¶1. (C) Summary: There is growing widespread and persistent Canadian lumber industry and provincial dissatisfaction with the July 1 U.S.-Canadian agreement to settle the longstanding and contentious softwood lumber dispute after a July 21 U.S. federal court decision in Canada's favor which encouraged opponents to hope for an eventual victory through litigation.

For now, Prime Minister Harper is staking his government's future on Parliamentary approval this fall of the Canadian export tax associated with the deal. International Trade Minister Emerson is trying hard to convince Parliament and the public that the deal is the best one Canada can expect, but this is proving to be a tough sell in light of opposition from several provinces, especially British Columbia, and from enough Canadian lumber companies who have enough market power to stop the agreement. Both the PM and Emerson agree that while they could win the vote in Parliament, the loss of support from the industry could kill the deal. End Summary.

¶2. (U) While Canada's largest lumber producer, Canfor, has expressed public support for the draft July 1 agreement, Canfor President Jim Shepherd said on July 31 that "common sense" suggests that the current deal is unlikely to get necessary backing from the Canadian industry without some changes. Two major British Columbia firms, West Fraser Timber and Interfor, have been quoted in the press as being dissatisfied with the deal as written and as trying to get it changed. However, the companies stopped short of saying that they would exercise the implicit veto that they have over its implementation (the deal requires that 95 percent of the Canadian industry support it, a high threshold that may be difficult to reach in the current atmosphere).

¶3. (C) There is also opposition to the deal from other major players, including the British Columbia provincial government, and industry associations in the four key lumber exporting provinces of BC, Quebec, Ontario, and Alberta. Saskatchewan's Forestry Minister told the press that the agreement is unfair and unworkable for his province. Manitoba

Premier Doer suggested to the Ambassador that since his province is a relatively small lumber exporter, he would take his cue from "the big guys." On the other hand, Quebec Premier Charest implied to the Ambassador that his government, while not happy with the current deal, would probably support it in the end. Alberta Conservative MP Rob Merrifield recently told the DCM that Alberta's industry favors the status quo, i.e., no deal.

¶4. (C) Opposition forces were given a boost by the July 21 decision in the U.S. Court of International Trade which favored Canada. Since then, International Trade Minister

Emerson has stepped up his efforts to save the deal, not so much by touting its merits, but by warning of the alternative of endless litigation. Emerson is particularly knowledgeable about the industry since he was Canfor's CEO prior to entering politics. The Minister told a House of Commons committee on July 31 that "negotiations" have ended, and that if the July 1 deal is rejected, there is no chance that another one can be negotiated for at least three years, and that a fresh round of the litigation cycle would be "ugly." The Minister warned to the House of Commons that "if we do not have sufficient buy-in from industry, there really isn't an agreement to bring before Parliament" after it reconvenes on September 18. Without support from "the appropriate number of players in the industry, you're dead on arrival," the Minister conceded. He suggested that killing the current deal would probably lead to another long trade war with the U.S., launched by U.S. lumber interests and Congress: "The choice is not between this negotiated deal and some Utopian model of free trade. Don't think we can walk away and, when we feel like it, negotiate another deal to our liking. That is not going to happen." Emerson later told reporters that he continues to meet with industry leaders about the deal. The Minister told the Ambassador in a private conversation that he sees only two options: sign-on to the July 1 agreement, or continue with costly litigation and escalating tariffs from the U.S.

15. (C) When the Ambassador raised the softwood lumber issue with the Prime Minister on July 30, Harper conceded that getting Parliamentary approval for the export tax portion of the softwood lumber deal in the fall would be "tough," but he still believes that he will have the votes for passage since none of Canada's four political parties or the

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public want to have another election so soon after the previous one in January 2006. Harper has already made it clear that he intends to treat the softwood lumber legislation as a vote of confidence that, if lost, could topple his minority government.

16. (C) The future for resolving the contentious softwood lumber issue remains unclear. Emerson is making a strong effort to sell the July 1 agreement during the six weeks before Parliament returns as the best deal Canada will get, and it still is possible that the Harper government in the end will be able to muster enough votes from the three other parties to garner approval for what everyone agrees is an imperfect deal. But a Parliamentary vote may never take place if industry opposition to the deal, as initiated on July 1, does not abate. Although the U.S. Coalition for Fair Lumber Imports has stated publicly that the proposed agreement is not open to further negotiations, we are not privy to discussions that might be occurring privately between the two industries to address the changes to the agreement that the Canadian industry seeks, such as a longer termination period, equal treatment for lumber processed from logs harvested on private lands in BC, and a reduced tax on remanufacturing.

17. (C) At this point we suggest that Washington not make any statement to try to influence the current internal debate within Canada. It's Canada's decision, and anything that we say might backfire and make Harper and Emerson's vigorous efforts to sell the deal to fellow politicians and to the public even more difficult than it is already proving to be.

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